

Friday, June 28, 1974

Dear Member:

Short-term borrowing costs are cresting right about now. That's the consensus of several top money-market experts today. There's wide agreement that the rise since March is really over, and that rates will now be easing over the next several months, though some banks' prime rates may well be hiked one more time.

What's the basis for these views of the near-term outlook? In early May we listed 5 key signs to watch for a coming reversal. The experts say these signs are now pointing to a rate downturn:

Inventory accumulation: The push to acquire materials stocks is easing, as availability of many items improves, scares end. And inventory financing loans will now return to normal as well.

Commodity speculation: Futures prices are falling rapidly in some commodities markets. Reports are becoming widespread of heavy order cancellations and dumping by European speculators who had bid up prices. Borrowing to speculate is also smaller.

Long-term financing: Theory is that borrowers have held off, hoping long-term rates would ease, borrowing short meanwhile. Pros say today's long-term money costs are now being accepted.

Decelerating inflation: The post-controls bulge is now past, and some industrial price indexes have actually fallen in June. But the experts say even a slower upward trend in price levels will be enough to take much of the pressure off interest rates.

International credit demand: Less foreign borrowing here, plus noticeably more foreign investing, are now becoming visible. Those who follow this area profess to see more "Arab oil money" flowing in, adding substantially to the supply of lendable funds.

There's much less agreement, though, over what comes next. One scenario sees the softening in the coming weeks continuing, dropping by easy stages to the area of an $8\frac{1}{2}\%$ prime by yearend. That's the majority view, but admittedly not a very firm one.

The other view, held by some of the most savvy specialists, is based on the "rule" that once rates stop climbing they plummet. This group sees a sharp drop, to about 7%, over several months, but then another rise starting, reaching a 9% or 10% prime again.

RIA Caution: Only weather forecasting has had a worse record lately than predictions of interest rates. Certainly the upturn in March caught virtually the entire financial community napping.

But since as an executive you have to make bets regardless, the odds now favor betting on somewhat lower short-term rates.

Oil and the energy crisis have moved front and center again. Another wave of pessimism is being reflected in all the media as the flow of petrodollars into Mideast coffers nears a flood. Here are some of the ultimate questions doomsayers are posing:

...Is the non-Communist world headed for monetary collapse, with worldwide deflation and a major depression sure to follow?

...Will sheiks and shahs become the monetary power brokers?

...Must industrial nations be impoverished to pay for oil?

The answers, according to the sober experts we've consulted, boil down to "not necessarily & probably not." Their conclusions:

First, the oil payments problem is serious and it will hurt, but meeting the bill is not beyond the industrial countries' means.

Second, Arab money can be recycled into the flow of capital, but when & how depends more on Western ability to halt inflation than on any Arab decision about their excess petrodollar billions.

Third, it may take another fuel crisis, probably this winter, to develop a long-range, coordinated, Western policy on energy.

Now, for the details on how these goals can be accomplished. Take the energy component in production and distribution costs. Since Oct., oil costs have added 2% to U.S. cost-push inflation, with another $1\frac{1}{2}$ percentage points pasted on come next January.

There is no escape from this extra pressure on costs, prices. Only way to offset this add-on factor is via higher productivity, reshuffled priorities if need be -- cutting out something else: power-guzzling gadgets, high-cost personal transporation, etc.

Next, the excess oil funds: They're a problem for Arabs, too. Producers are shopping around for arms, capital goods, investment. But as long as inflation rages, they fear longer-term commitments. That's why so much oil money has gone into short-term paper only.

But already there are signs of a shift in the Arab attitudes. British banks report a movement toward longer-term investments. Talks between the Saudis & the U.S. on a \$1 bill. a mo. investment in special U.S. Treasury paper are said to be progressing slowly.

Nevertheless, complete recycling requires economic stability. In these days that can mean only one thing: much less inflation. And that's up to economic policymakers in the developed world.

Finally, there is the need for a coordinated energy policy. Last winter's resolve to get cracking has already dissipated -- largely because shortages eased this summer even as prices rose. That will change as winter returns with yet another fuel crunch. When gasoline prices rise another 12%, heating oil by about 20%, natural gas by 25%, public pressure will force governments to act.

This time chances for U.S.-Europe-Japan cooperation are good. Some formula will be found to allow the oil importers to survive, while giving the exporters a take rich enough to satisfy them.

In short, the shape of major changes is beginning to emerge. There is wide acceptance that the era of cheap oil is finished. Economic adjustments to higher energy costs are being made slowly. The Persian Gulf nations are becoming centers of capital resource. A ragged program for developing new energy sources is taking shape.

Life won't be as easy as it has been or as rich & plentiful, but economic disaster isn't inevitable or just around the corner.

If Alan Greenspan takes the job as Chief Economic Adviser, which has been offered him, that's precisely what he will be. He has made that his minimum condition for accepting the post.

Greenspan, long an informal consultant to the Nixon Admin., is one of the most respected men in investment & economic circles. An outspoken conservative, he'd help crystallize policy views.

Note, though, that Greenspan's rise would downgrade others. Budget Chief Ash, Economic Counselor Rush, would lose influence. In fact, Rush might leave the Admin. if Greenspan moved into it.

The Moscow summit will not be another triumph for Kissinger. His star may well be past its zenith, could take a further plunge, with the kudos of years past battered along four battle fronts:

U.S. Jews are angry at what his Mideast truce has produced -- the guerrilla raids, Arab governments' threats of more war, etc. Any peace deal, they fear, might ultimately mean the end of Israel.

SALT policy critics are waiting to get at him after Moscow. If no curb on MIRV's is agreed on, he'll be charged with failure. If one is set, it'll be called too high to have any real effect. Any new trade pact will be denounced as financing the U.S. enemy.

Defense Dept. foes are also planning new whacks at Kissinger. They have more and more resented his take-charge negotiating ways, claim he has given away too much in his haste to make agreements. Top Pentagon aide Nitze's resignation was only the opening shot.

Nixon's political opponents will take full advantage of this. Up to now, Kissinger's successes have been Nixon's one big asset. Open season on Kissinger will be a prime way of getting at Nixon.

Two questions have been raised by Kissinger's changed status. One, what could he do to reverse the decline in his fortunes? The other, what effect might the attacks have on the detente?

On the first, he could uncover new fields for breakthrough -- there's still China, South Asia, Latin America, possibly Africa.

But if not, there's little paydirt left in Europe or the Mideast.

On the second, the attacks will hurt detente but not break it. Nixon, his critics, and the Russians are all agreed on one thing: Disappointing or not, there's no alternative to detente in sight.

Kissinger's problem is that detente has hit the "dull" stage. All the gritty little details, long postponed, must be faced -- how big a loan, what kind of technology, how many missiles, etc.

But that will take a Sec. willing & able to manage all this. Whether Kissinger is interested in doing that remains to be seen. He has never shown any love for administration -- or politics. With both now turning hard and bloody, he may decide he's had it.

Federal Trade Comm. has eked out one more narrow victory in its fight to get more and better data from giant corporations. The House partly restored cuts made by its Appropriations Comm., and there's a good chance the Senate will be even more generous.

At stake in the latest infighting were 2 key FTC programs: Line-of-business surveys had earlier been okayed in a maneuver that took FTC surveys out from under Office of Mgmt. & Budget. But then the Appropriations Comm. tied crippling strings on them.

This week the full House untied the knots to a major extent, and FTC is now planning to go ahead with the controversial plan. It will ask for detailed product-line data on sales, profits, etc. from 250 of the nation's largest corporations, covering FY '73. And if the Senate & a conference committee go along, as expected, it will expand the survey to cover all 500 of the biggest firms.

The line-of-business figures are considered crucial by FTC. Without them, the agency says, its industry analyses are hobbled. The big conglomerates, which are major factors in several fields, report their sales & profits consolidated, not by product line. Thus, concentration and its economic effects can't be evaluated.

Second -- though overshadowed by the battling over L-O-B -- the House restored nearly \$1 mill. to the FTC budget for the year, permitting it to put in an extensive new data-processing system. Point: The new EDP setup is the heart of FTC's antitrust probe into the petroleum industry, especially the 8 biggest companies.

RIA Observation: Staff morale at FTC, pretty low recently, has rebounded sharply. Chairman Engman is something of a hero. Privately, top agency people say Watergate has helped enormously, allowed the FTC to adopt a tough new stance without interference.

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